REPORT OF THE
STATE CORPORATION COMMISSION'S
BUREAU OF INSURANCE

# To Study and Report on the Liability Insurance Needs of Day-Care Centers and Family Day-Care Homes

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

# House Document No. 32

COMMONWEALTH OF VIRGINIA
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THOMAS P. HARWOOD, JR.
CHAIRMAN

ELIZABETH B. LACY
COMMISSIONER

PRESTON C. SHANNON
COMMISSIONER

COMMONWEALTH OF VIRGINIA

MARY LYNNE BAILEY
DIRECTOR

DIVISION OF INFORMATION RESC
BOX 1197
RICHMOND, VIRGINIA 23209
(804) 786-7141

**STATE CORPORATION COMMISSION**

January 15, 1987

TO: The Honorable Gerald L. Baliles
Governor of Virginia
and
The General Assembly of Virginia

The report contained herein is pursuant to House Joint Resolution No. 93 of the 1986 Session of the General Assembly of Virginia.

This report represents the response of the State Corporation Commission's Bureau of Insurance to the legislative directive to study and report on the liability insurance needs of day-care centers and family day-care homes.

Respectfully submitted,

Thomas P. Harwood, Jr.

Thomas P. Harwood, Jr., Chairman

Elizabeth B. Lacy

Elizabeth B. Lacy, Commissioner

Preston C. Shannon

Preston C. Shannon, Commissioner

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## EXECUTIVE SUMMARY

### Legislative Request

House Joint Resolution No. 93 directed the State Corporation Commission to study the problems which have resulted in the high cost of liability insurance coverage for day care centers and family day care homes and to make recommendations which may result in assisting insurance companies make coverage more available and reduce liability insurance premiums.

According to the General Assembly resolution:

1) Day care centers and family day care homes, which have grown rapidly in number in recent years, provide an invaluable service to our society by allowing parents of pre-school aged children to continue in their careers and provide a more acceptable standard of life;

2) The threat of potential liability, especially in providing human services, requires day care centers and family day care homes to carry many types of insurance, yet many day care facilities in the Commonwealth have experienced difficulty in obtaining liability insurance coverage;

3) Although liability insurance seems to be more available recently, centers and homes able to find coverage are being required to pay excessively high premiums, thus greatly impacting the cost of services to the consumer and making day care prohibitive to many; in addition, some facilities have insufficient coverage which leave them exposed to liability; and

4) The Virginia Department for Children, in its 1986 State Plan for Child Day Care, listed the assessment of insurance costs and how they can be reduced as crucial to the improvement of day care services.

### The Day Care Crisis in Context

The liability insurance crisis is not unique to the day care industry. Reductions in liability insurance coverage, policy cancellations or nonrenewals, and drastic premium increases have been experienced by many different types of businesses nationwide. What is different about the day care crisis is that the problems with obtaining and affording liability insurance are interacting with other dilemmas unique to day care. For instance, day care providers offer a service that is used more out of necessity than desire by consumers who, in many cases, cannot afford to have increased costs passed on to them because of higher insurance premiums for their day care provider's operation. Those day care providers attempting to absorb the increased costs, themselves, frequently have resulted to lower staff salaries, elimination of certain services, or overall decreased quality of care. Another problem is the label of high risk that has been attached to day care. Day care has always been a small, low-profit market for insurance companies and according to available data, the losses for Virginia child care claims are higher than the premiums paid for the coverage. The potential liability involved whenever children are the issue has only been exacerbated by the relatively few, although much publicized, child abuse cases in child care. These problems, occuring at the same time insurance companies are reacting to a general liability insurance crisis, have converged to adversely affect the day care industry's ability to offer its services in the manner needed by parents throughout Virginia.

## Affordability Versus Availability

After hearing testimony at four public meetings across the Commonwealth and reviewing information gained from survey responses of day care facilities licensed in Virginia, much of the day care liability insurance problem appears to center around the issue of affordability. The family day care homes with more than three children in care stand out as still having problems in finding insurance, some going without liability coverage at all. Other family home providers have been faced with losing their personal coverage under their homeowners insurance policy because they take care of children in their homes. Beyond these problems, the concern turns to the drastic increase in premiums for day care facilities that do not have such contingency funds immediately - if at all - available and cannot pass the costs on to their consumers. Although a review of the insurance companies offering liability insurance for day care facilities in Virginia indicates that coverage is in fact available, the day care industry argues that a fine line exists between insurance that is unaffordable and insurance that is unavailable. In other words, while coverage may be offered, the cost for many is so prohibitive that availability becomes a moot point. The question of what is affordable, however, goes beyond the means of this study.

## Options to Be Considered

There are many efforts being made by other states to resolve the liability insurance crisis in general as well as the problems being faced by day care facilities. In Virginia, a separate legislative subcomittee is studying possible insurance and tort reforms through SJR 22. HJR 93 was passed as a supplement to that study and will therefore not duplicate the efforts of SJR 22 but instead supportively point to its final recommendations.

Options to be considered by the Virginia General Assembly have been identified in light of this study's attempt to examine the extent and nature of the problem. Potential solutions to help day care providers need to incorporate more than insurance mechanisms and many go beyond the scope of the study since the problems faced by the day care industry reach beyond insurance. Options directed at the problem of availability include market assistance programs, joint underwriting associations, pooling, and limits on policy cancellations, nonrenewals, and rate increases. Options that might assist in making insurance more affordable for day care include tort reform, increased claims data, tax advantages for companies writing day care coverage, claims-made policies, modification of licensing standards for day care, and public assistance measures.

# GENERAL ASSEMBLY OF VIRGINIA -- 1986 SESSION

## HOUSE JOINT RESOLUTION NO. 93

*Requesting the State Corporation Commission to study the liability insurance needs of day-care centers and family day-care homes.*

Agreed to by the House of Delegates, January 30, 1986
Agreed to by the Senate, March 6, 1986

WHEREAS, day-care centers and family day-care homes provide an invaluable service to our society by allowing parents of preschool-aged children to continue in their careers and provide a more acceptable standard of life; and

WHEREAS, the use of day-care centers and family day-care homes has increased rapidly in recent years and the proliferation of these centers and homes has provided not only more available services but also more jobs; and

WHEREAS, the threat of potential liability, especially in providing human services, requires day-care centers and family day-care homes to carry many types of insurance; and

WHEREAS, numerous facilities in the Commonwealth have experienced difficulty in obtaining liability insurance coverage; and

WHEREAS, although insurance seems to be more available recently, the centers and homes able to find coverage are being required to pay excessively high premiums or have insufficient coverage which leave them exposed to liability; and

WHEREAS, these excessive premiums are greatly impacting the cost of services to the consumer, which makes day care prohibitive to many; and

WHEREAS, insurance was ranked as a leading cause for concern by providers when asked about priority issues in determining affordability of care; and

WHEREAS, the Department for Children, in its State Plan for Child Day Care, 1986, has listed the assessment of insurance costs and how they can be reduced as crucial to the improvement of day-care service; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the State Corporation Commission be requested to study the problems which have resulted in the high cost of liability insurance coverage for day-care centers and family day-care homes and to make recommendations which may result in assisting insurance companies to make coverage more available and to reduce liability insurance premiums.

The Commission shall report its findings and recommendations to the 1987 Session of the General Assembly of Virginia.

## INTRODUCTION

Child day care providers are facing rising operational costs which are making the continuation of their services increasingly difficult. Of particular concern to them at this time is the rising cost of liability insurance. Liability insurance is the only financial protection against a costly lawsuit. Without this precaution, simply defending against a legal action could bankrupt a small business such as a day care center, and even threaten the day care provider's personal financial resources. In addition to being a requirement for licensure, the purchase of liability insurance is a sound business practice and a necessary resource for compensation should a child be seriously or permanently injured while in care. The problem is that, as with so many other businesses, day care providers have recently experienced an upsurge in insurance costs that in some instances have exceeded 300%. Some providers contend they cannot find coverage at all. The day care industry is apprehensive, maintaining that these costs, when insurance is available, are becoming prohibitively high, are threatening the financial viability of many day care facilities, and are sufficient enough to put some of them out of business.

This problem, while affecting all businesses nationwide, appears to be particularly more compelling for the day care industry. Society - especially two income parent families and, even more so, single parent families - has become critically dependent on day care facilities for self sufficiency and maintenance of an acceptable standard of living, making affordability of day care crucial. In many cases, the day care consumer is from the low to moderate income level already. According to the the Virginia Department for Children's 1986 State Plan for Child Day Care, 45% of Virginia families who potentially needed day care in 1985 were making less than $20,000 while child day care services averaged $41.62 per week. The State Plan concluded that these families, as well as families with more than one child or an infant, were likely to spend over 10% of their income to purchase day care services and 10% is the maximum figure generally recognized as affordable. Unlike most businesses, many day care facilities simply cannot pass the costs of increased premiums on to these consumers.

Some day care providers have attempted to absorb the increased costs, themselves. Yet, even before the liability insurance problems arose, the financial resources of the day care industry were limited. Day care providers operate amid difficult financial conditions with erratic, unpredictable, and unstable revenues. At a public meeting on the subject, one day care provider summarized the opinion of many who spoke, stating: "Providing children with more sophisticated equipment and better trained teachers has created more costs to today's well run center. Without any outside influences, child care directors already have an extra sharp pencil to keep a center in the black. Increased state regulations [affecting the amount of liability coverage required for licensure] have recently added another whopping expense to our cost line. Considering the above facts, the insurance crisis now threatens the very existence of most small and large providers." The liability insurance problem has forced many day care operators trying to absorb the increased costs to change their operations or eliminate some of their services entirely in an attempt to survive financially.

Some of the facilities have simply closed either because they could not afford the insurance increases or because they could not find coverage at all. On the other hand, programs that can find insurance but are unable or unwilling to pass the increased costs on to the families served, have to decide between sacrificing the quality of care they provide or foregoing program improvements or salary increases for staff members in order to meet the expense.

Even without the financial burden of increased liability rates, the Virginia Department for Children claims there are not enough facilities available for the many children in need of day care. In 1984, there were approximately 60,000 licensed day care openings available statewide for 300,000 children estimated to be in need of care. Currently, there are some areas in Virginia that have no day care centers at all and there are counties where local departments of social services cannot find family day care providers willing to care for children of low-income families who are eligible for assistance and in need of services. The availability of subsidized care for low income citizens has dropped dramatically since 1981 due to massive reductions in federal funding. The affect of the liability insurance crisis has only served to exacerbate the availability of day care problem.

Unlike consumers of other types of products, parents are not in the position of choosing whether or not to purchase this service; many must have child care. When day care centers and family day care homes shut down, parents at all income levels are faced with the possibility of placing their children in unlicensed facilities - if they can be found - that might not even meet the most basic minimum standards for quality and safety. Otherwise, these parents must choose between leaving their children unattended or giving up their jobs and staying home. The fact is that the availability of quality child care is directly related to the economic well-being of the Commonwealth. Lower unemployment rates, increased tax revenues, and decreased public assistance dependency are all potential positive outcomes of having quality day care available. The problems faced by the day care industry, therefore, affects all of Virginia.

The day care industry has been working hard to meet the needs of the Commonwealth and, among other accomplishments, was responsible for the 1985 successful passage of House Bill 1696, providing for the Virginia General Assembly's first policy statement on child day care services in Virginia. As a result, §2.1-553.2 of the Code of Virginia clearly states:

> It is the policy of the Commonwealth to promote the development of quality day care facilities which are safe, healthy, accessible, and affordable to the many Virginia children who need and would benefit from such services.

The day care industry is very concerned that the insurance crisis will undermine their recent efforts to upgrade and improve child care services in Virginia. Therefore, during the 1986 Session, they successfully requested that the Virginia General Assembly adopt House Joint Resolution No. 93. This legislation directed the State Corporation Commission to study the nature and extent of the liability insurance problem for day care facilties and to make recommendations which may result in assisting insurance companies to make coverage more available and to reduce liability insurance premiums.

## THE DAY CARE CRISIS IN CONTEXT

Three factors have converged to create the liability insurance crisis for day care. First, the day care industry has experienced an enormous growth in a very short time, creating an unprecedentedly high demand for liability coverage. Second, a label of high risk has been placed on day care at the same time a general liability insurance crisis is occuring for all kinds of businesses. Limiting liability coverage for high risk clients, making coverage available but dramatically raising rates, decreasing the amount of coverage available, and adding specific exclusions to the policies, are some of the measures the insurance industry has taken to protect itself during this difficult economic period. And third, allegations of physical and sexual abuse in child care centers have been highly publicized, exacerbating the insurance industry's perception, as well as that of the general public, of high risk in child care.

### Growth in Day Care

Men and women have the same financial and nonfinancial reasons for working: economic survival, raised standards of living, and personal satisfaction. Yet, only between 1950 and 1986 had married women with children entered the labor force in such record numbers, with nearly 52 million women joining the workforce by 1986. The most dramatic increase in female labor force participation over the last decade has been among women with children - in particular, those with very young children.

The result of this growth rate is that more and more women are faced with the search for family day care homes and child day care centers to procure care for their children so they can work. Child care is no longer considered a luxury and, in fact, has become a necessity for many families. Without available, affordable child care, many are faced with choosing between an unsupervised child or the family's economic survival.

The day care industry is growing dramatically in an attempt to keep up with these increasing demands. The proliferation of licensed day care facilities in recent years is well documented and licensing criteria have been modified as the demands have changed. Currently, all day care centers must be licensed by the state with the exception of facilities operated by hospitals for their employees, municipalities or counties, or state agencies and institutions (colleges and universities). A day care center is defined as any facility operated for the purpose of providing care, protection and guidance to a group of children separated from their parents or guardian during a part of the day only. A private home where group care is provided to 10 or more children and any place other than a private family home where group care is provided to any number of children is included in this definition. Church-related child care centers which file required information are exempt from all licensing standards except for ratios of caregivers to children, medical requirements for staff, and fire and health regulations. Any religiously exempted center has the option of being licensed, and publicly operated centers have the option of being certified as meeting licensure standards.

A family day care home must be licensed as such if care is given to more than five but less than ten children. A family home is defined as any private family home in which children are received for care, protection and guidance during only part of the twenty-four hour day except 1) children who are related by blood or marriage to the person who maintains the home, or 2) homes which accept children exclusively from local departments of welfare or social services. A family home with five or less children is not required to be licensed and a home with ten or more children must be licensed as a child care center. Family homes may also be qualified as certified Title XX homes meaning they meet the eligibility criteria necessary for Title XX funding.

According to the Virginia Department for Children's 1986 State Plan for Child Day Care, there were only 352 licensed day care centers in 1973 (there were few exemptions at the time) and 525 licensed homes (there were no certified homes). As of August 1985, without including the 90 church-exempt centers and 11 hospital-sponsored centers operating in Virginia, there were 737 licensed centers caring for approximately 57,254 children, 188 licensed child care homes caring for approximately 1,600 children, and 700 Title XX certified family homes caring for from one to nine children each.

Unfortunately, the growth by the day care industry to meet the rapidly changing needs of society has complicated the insurance industry's use of traditional methods for calculating risks. Liability risks in the child care field are numerous. Day care providers can be sued for anything from sexual abuse to food poisoning to auto accidents in provider-owned or rented vehicles transporting children to and from the facility. Traditionally, insurers use risk classification to establish a fair price for insuring an uncertain event. Estimates must be made of the probabilities associated with the occurrence, timing, and magnitude of such an event, normally using information about past experience, coupled with projections of future trends, for groups with similar risk characteristics. This increase in the number of day care facilities within the last 10 to 15 years together with a few very large claims in recent years has left insurance companies without the historical data necessary to conduct proper loss trending and thereby predict the risk involved in insuring day care.

And while a definite growth in day care has occurred to meet the increasing needs of parents in Virginia, it is still not ideally enough. Day care providers in many areas of the state report long waiting lists. The situation is so grave that, in some cases, would-be parents are placing themselves on waiting lists for child care before the child is conceived. Until adequate trending information is available and the liability insurance crisis eases, the realities faced by the day care industry is that continued growth will only be hampered by the problems caused by the liability insurance crisis, intensifying the already fragile and fragmented condition of child care in Virginia.

## Day Care as High Risk/ Liability Insurance Crisis

The problems caused by the absence of predictability - the ability to project with reasonable certainty the relation between premiums paid in and claims paid out - for day care risks have been exacerbated by the nationwide liability insurance crisis affecting many different kinds of liability insurance consumers. General liability refers to the hazards arising from the operations involved in conducting a business or profession. A liability insurance policy is a third-party contract requiring the insurer to pay on behalf of the insured all sums which the insured may be legally obligated to pay as damages to a third person who has suffered injury or property damage. The third person is not a party to the contract and is not even known until the insured has caused, or is alleged to have caused, injury or damage. Unlike property insurance, where the existence and nature of possible losses must be clearly known and understood at the time insurance takes effect, neither the nature nor the extent of injury or damage can be determined for liability insurance until the accident occurs.

Predictability is of critical importance to insurability. If the costs of the injuries are not predictable, the cost of insurance must reflect extremes in risk to protect against extreme judgements which may be rendered in courts. Some insurers maintain that identifying how many big awards are paid out for broken arms is more pertinent than estimating the physical risk that a child will get injured. Companies can no longer only use time-proven actuarial tables to tell them how often a little boy will break his arm on a set of swings at a day care center, how much the medical bills will be and, thus, what the premium should be. They are trying to calculate as well the likelihood that the child's parents will sue the facility for negligence and win from a sympathetic jury a million dollar settlement for psychological trauma.

Providing liability insurance for a business that cares for children raises a special set of risks because not only can parents sue if their child is injured, but children can sue when they grow up. And an injury to a child may not manifest itself for years. A major problem with insuring child care is the unknown potential for claims filed due to accidents years after the child has left a day care program. The younger the injured parties are, the more time they have to sue.

The cyclical nature of the insurance business has only added to the problems being faced by many businesses looking for liability insurance. Interest rates were high in the late 1970s and early 1980s. Insurance companies engaged in heavy competition for premium dollars by significantly cutting premium rates to increase the volume of premiums written and then invest the additional money gained. Prices were cut well below the amount actually needed, but the profits earned on investments were used, in part, to off-set any underwriting losses incurred. When premiums were driven too low and interest rates began to fall, insurers tried to compensate by raising prices and getting out of the type of businesses that had resulted in big claims and heavy losses.

Day care was identified as a high risk business by the insurance industry. The fact that day care services are dealing with children only makes them that much more vulnerable than other types of businesses to emotional charges of liability resulting from negligence and carelessness. Yet, the day care industry has rejected the high risk label. They point to studies by the Child Care Action Campaign, the Children's Defense Fund, and the National Association for the Education of Young Children, that indicate a low pattern of risk based on experience of actual liability claims for day care facilities. The insurance industry acknowledges that the bulk of payouts on child care claims are not liability related but instead cover the medical bills from injuries due to slips and falls. Most general comprehensive policies will cover medical expenses and civil suits resulting from ordinary "playground" accidents. The freak occurence - an incident of sexual abuse or a bus accident - is what attracts the severe claims. And the possibility (but lack of predictability) of that severe claim is what concerns insurers the most.

Child Abuse Publicity

Child care has always been a small, low-profit market for insurance companies and now is considered to be even more of an undesirable market to insure because of the potential for large claims due to alleged child abuse. Insurance companies throughout the nation have reacted to the highly publicized child abuse cases in New York and California with drastically increased premiums or with cancellation or nonrenewal of policies for child care facilities. Although it appears that the entire day care industry is being penalized because of incidents of child sexual abuse that allegedly occurred in just a few centers, insurance company officials maintain that the potential for huge claims involving child sexual abuse is enough to scare off much of the property/casualty market because insurers need contingency funds in case of claims. If a case of child abuse is actually proven, every parent with a child in that center will come with a claim. Even if the claims are frivolous, the insurance companies may have to pay out untold sums in legal expenses.

Day care providers assert that more and more policies for day care liability now exclude coverage for claims of child abuse and even allegations of child abuse and yet the insurance industry uses the argument of potential child abuse claims to justify increased premiums, policy cancellations or nonrenewals. Although problematic for all types of day care facilities, sexual abuse exclusions are particularly difficult for infant care providers where the insurance concern is greater because they are involved with more physical contact. The state requires, for instance, that a baby be held when fed and of course diapers must be changed. While there are few centers in Virginia that take infants, there is a tremendous need (centers report turning away 30 infants a year) but the liability is often seen as too great. And, as is the case many times when licensed facilities are unavailable, these infants may be going into private homes that are unregulated. The insurance industry's justification for the sexual abuse exclusions for any kind of day care facility is that they cannot yet predict if courts will make them pay claims on intentional criminal acts such as child sexual abuse, for which insurers did not expect to be held liable. Most companies' policies cover negligent supervision for common occurrences like slips and falls. But while accidents arise out of negligence, child abuse is an intended act.

Several cases, outside of Virginia, are now pending in which the court will decide whether to require insurance companies to pay awards in which parents of sexually abused children have filed civil suits against the day care providers for negligent supervision. And although the day care industry has requested that rates in Virginia be based on the claims history of Virginia and not the few events occurring elsewhere, two recent cases of sexual abuse in Virginia family day care homes will have a tremendous negative effect on day care in the Commonwealth. One case resulted in a $828,000 jury verdict. Defense attorneys asked that the verdict be set aside, but the decision is still pending.

The policy of "joint and several liability" also increases the risks for insurers in a child abuse claim. Under this policy, courts can require a defendant who is only slightly responsibile for a plaintiff's loss to pay the entire loss because of the financial irresponsibility of a co-defendant who is a larger contributor to the injury. Some states have abolished their joint and several liability policies or at least placed some kind of restriction on them.

## STUDY CHARGE AND METHODOLOGY

The charge of HJR 93 was to study the problems which have resulted in the high cost of liability insurance coverage for day care centers and family day care homes and to make recommendations which may result in assisting insurance companies to make coverage available and to reduce liability insurance premiums. With this in mind, the State Corporation Commission's Bureau of Insurance took steps to thoroughly document the extent of the liability insurance affordability/availability problem being faced within the day care industry.

Four public meetings were held in Norfolk, Roanoke, Richmond, and Fairfax to gather testimonies from day care providers around the state. Fifty day care operators presented their concerns about obtaining and affording liability insurance for their operations. In addition, all day care facilities licensed in Virginia were surveyed to supplement the public meeting testimonies and document the problem further. Thirty percent of the day care centers and family day care homes licensed in Virginia responded to the provider survey. (Specific results are found in Appendix A)

A second survey was sent to all property and casualty insurance companies licensed to do business in Virginia to identify those that are writing day care and to determine what day care facilities can do to make their risk more predictable and therefore lower rates. From the 67 percent that responded to the company survey, 38 companies indicated that they offer some type of day care coverage and provided some insight on the insurance company perspective of the problem. (Specific results are found in Appendix B)

Finally, data was collected from other state insurance departments to determine the nature of the problem elsewhere. Forty-one other states provided information on the magnitude of the problem in their jurisdiction and identified their attempted solutions. (Specific results are found in Appendix C)

## RESULTS OF STUDY

The major issues that were researched include: 1) availability of insurance, 2) affordability of insurance, 3) claims data, and 4) effects of the liability insurance crisis on day care operations.

### Availability of Insurance

Liability insurance is an absolute necessity for child day care. In fact, new regulations for day care centers became effective in April, 1986 that increased the amount of liability insurance required for licensure from $300,000 to $500,000. From the testimonies given at the public meetings and from the day care provider surveys, this increased requirement combined with the already apparent apprehension of insurance companies toward day care resulted in requests from day care providers for the increased coverage being denied, costing much more or covering much less than the previous amount.

According to the survey of day care centers licensed in Virginia (Appendix A) 23 percent of the facilities responding had their insurance cancelled or nonrenewed within the past year. Reasons given to day care providers by their insurance companies emphasized blanket statements that "the company no longer provides insurance for day care risks". While only 8 insurance companies responding to the company survey indicated that they had written day care coverage within the last five years but had stopped, of the 38 companies indicating that they currently offer some kind of day care coverage, 30 offer coverage for commercial centers. However, of that 30, nine indicated that they are accepting no new business and 14 will only write coverage if the center is part of a larger risk such as a church. (Appendix B) For most of these companies, child care represents a very small percentage of their business.

Many day care facilities around the country have seen their liability insurance premiums significantly escalate in 1985 and 1986. Many centers and family homes have been threatened with the possibility of closing because of the high cost of insurance. In some states, insurance for day care liability risks was scarce, if at all available. In the survey to other state insurance departments (Appendix C), 36 of the 41 states responding indicated that day care operators had experienced problems with cancellations or non-renewals of their liability insurance policies within the past year. Rate increases in other states were similar to those found in Virginia when insurance was available and when it was not available, family home providers appeared to be the hardest hit.

The information received through the testimonies by day care providers at the public meetings indicated that affordability of insurance appears to be more of an issue than availability for day care centers but many family day care homes traditionally covered under their homeowner's policy are finding themselves without coverage for their day care operations if they have more than three children. Some have even lost their homeowner's coverage altogether.

Thirty-nine percent of the family homes responding to the day care provider survey indicated that they did not carry any insurance on their day care operation in the first place, either by choice or because they could not find it. Only 13 insurance companies responding to the company survey indicated that they offer coverage for family day care homes. Of that 13, one is limited to directors and officers liability only, one limits incidental occupancy to two children so that coverage is provided under the homeowners, one offers coverage for up to six children but prefers not to take any new business, and 10 use the ISO or similar endorsement for homeowners that provide coverage for a maximum of three children in the home. Since the time of the survey, one company has expanded the three children limit to six.

Insurance companies that offer homeowners policies never intended for coverage to be extended to business pursuits. Court interpretations, however, have resulted in exceptions being made for incidental coverage. Many companies are now finding that this incidental use of homeowners policies to cover day care is not profitable and are either specifically excluding coverage for day care operations or not offering coverage at all in any situation involving day care thus clarifying the original intent of homeowners coverage. Some of these companies have attempted to fill the resulting void with a day care endorsement but a limit of three children in the home has been frequently viewed as the maximum capable of being handled under the homeowners policy premium structure.

Several family home day care providers testified at the public meetings that their homeowners insurance policies were cancelled solely due to the fact that they are caring for children in their own home. They complained that this practice has forced them to seek homeowners insurance elsewhere and often they can only find limited coverage at a much higher cost. Besides the fact that these individuals must have the homeowners coverage for their personal family needs and as a requirement for Virginia house loans, an additional dilemma for family day care home providers is that if they find homeowners coverage that excludes protection for their day care operation, they run the risk of losing their home and all of their personal items if they are sued.

Some home providers reported that even though they had separate liability coverage for their day care operation, their homeowners insurance was cancelled because they were watching children in their homes. One speaker indicated that her coverage was nonrenewed for all insurance - fire, theft, not just liability.

One family home provider who keeps 4 children, charges $45 a week per child, serves three meals a day, teaches and goes on field trips, had his day care insurance cancelled. He tried to get coverage in connection with his existing homeowners policy but the company would only offer a rider if no more than three children were in the home. He looked elsewhere and found what he thought was day care liability coverage and homeowners. His agent told him he would write a day care policy only if he also wrote the day care provider's homeowners policy. The day care provider cancelled his existing homeowners policy and accepted the policy from this agent. He then received a letter from the company two weeks later informing him that this new homeowners policy would be cancelled because he was supervising children in his home.

Many of the day care providers who testified echoed the frustrations of one who stated: "The question is no longer, how much is the premium?, but will you insure my business? And if insurance can be found for 1987, who is paying for the increases? Our parents, our staff, and ultimately our children."

Affordability of Insurance

The major concerns voiced by the day care center providers able to find coverage and echoed by the family home providers, focused on the drastic increase in the cost of premiums. Of those day care centers responding to the survey that could find insurance, close to one-third reported increases over 100% and 10% indicated that their increases exceeded 300%. More than one-fourth of the family day care homes responding to the survey that did have insurance reported premium increases over 100%.

During the public meetings, day care center providers cited premium increases such as one that went from $350 a year in 1985 to $2645 in 1986. The figures varied from center to center based on size and operation but the high percentage of increase was common among those who spoke. Many indicated that they understood the need to increase rates due to economic factors but they asserted that budgeting such substantive increases is almost impossible for a day care operation, suggesting that perhaps smaller increases over time resulting in the same final figure but at a manageable pace would be more realistic.

A nonprofit United Way Agency that operates three day care centers, caring for more than 350 children, reported a 1985 liability insurance cost of $1,070 for $500,00 coverage. The same coverage in 1986 cost $9,000 - an 850% increase. In addition, they could not find any insurer willing to offer an umbrella policy after the underlying $500,000 was in place.

Reports from family home providers of premium increases from $30 to $1,200 a year were not uncommon. One provider disclosed that her annual premium for 1982 and 1983 was $50 for a million dollars worth of liability coverage. In 1984, the premium was $80 for the same million dollar coverage. By 1985, the child care coverage was decreased to $500,000 for $250 a year and she also had to sign a waiver relating to any charges of sexual abuse.

Day care providers, and especially those who serve families receiving federal or state assistance, have limited income available. If a child is accepted from the Department of Social Services, the day care facility is paid a specified amount depending on the region of the state (in the Chesapeake area, for example, $ .60 an hour is paid per child) but the families do not have money to add to that. Since family homes are restricted to a certain number of children both because of licensing restrictions and insurance availability, and if these children are accepted from Social Services, the homes simply cannot absorb the extra cost of increased premiums.

Many of the availability problems experienced by day care operators were intensified after a 1986 change to the licensing requirement for day care centers mandated $500,000 of liability insurance coverage instead of the previous $300,000. Some day care providers testified that when they asked their company for the increase, their entire policy was dropped. When one provider tried to find coverage elsewhere, her agent was quoted $4,200 for the $500,000 coverage needed versus the $800 they had been paying for the previous $300,000 in coverage.

Another day care provider talked about purchasing a commercial umbrella policy in 1985 to increase her liability coverage in light of the nationwide climate of increased litigations and excessive awards. The premium for the $1 million additional coverage was $300 a year. The premium for her existing multiperil policy ($500,000 coverage) was $275 a year. At renewal, the multiperil policy was written on a three year contract for $1,842 or yearly installments of $614 (more than doubled). The umbrella policy went up to $1000 (more than tripled).

One day care provider simply asked: "What are we to do? How can the state say we have to have $500,000 when we can't get it? In the past, tuition fees have gone up only one or two dollars. This year we were forced by the insurance company to raise our weekly fees by $10.00. Must I wait anxiously through every February [renewal date] for a letter from my insurance company cancelling my liability insurance? This is not the way I want to run my center or plan for its future. I need the security of good sound liability insurance."

## Claims Data

One of the frustrations most often voiced with the liability crisis is the claim by day care providers that the loss of insurance or the rate increases have no bearing on the professionalism, quality or claims history of the programs affected. The day care industry maintains that there are no claims data that support the classification of child care as high risk. A frequently quoted survey conducted by the National Association for the Education of Young Children (NAEYC) reported that of 269 child care facilities surveyed, nine out of 10 programs had never filed a claim on their liability insurance policy. Of the 10 percent that filed claims, 80% were under $500, and the highest single claim was $15,000.

During the public meetings, speaker after speaker testified that their liability policy was nonrenewed in spite of having had coverage for many years, with no liability claims and with a highly professional operation. One provider reported that her center had been in operation for 33 years and although she stated that she never had an insurance claim, she received a notice that her policy was to be cancelled "for no apparent reason".

Insurance companies usually calculate rates for day care on a per-child or per-square foot basis, and the rates vary depending on the claims history or different regions of the nation. One request from the day care industry heard during the course of this study is to have rates based on Virginia experience so that the recently increased licensing criteria and "conservatism of the state" would be reflected in the premiums paid. In the company survey, most of the 37 companies that write day care coverage indicated that their Virginia experience in day care is so small as not to be credible. A representative from one large insurance company stated that they wrote less than $75,000 in premiums over the last five years. Most of these companies rely on data from the Insurance Services Office (ISO), an organization that develops advisory rates nationwide.

Insurance companies are private enterprises and, like any other company they are in business to make a profit. They maintain that insuring day care risks is a losing proposition. According to ISO's data listed in Figure 1., the insurance industry nationwide lost money on child care premiums in 1982, 1983, and 1984, while the number of child care claims increased. Figure 2. lists data in which Virginia figures are found to be better than the national statistics in 1984 (the last year for which data are available); but Virginia then showed extremely high loss ratios for 1982 and 1983. In 1982, for instance, the dollar amount for the total limits earned premium - or the total amount of premiums paid in - was $46, 394 while the combined basic and excess limits incurred losses - or the total amount of claims to be paid out - was $150, 461, resulting in a loss ratio of 3.243. In other words, more than three times the amount of premiums taken in was needed to pay claims for that year. The generally typical loss ratio necessary to generate an underwriting profit is about .60 which takes into account such additional expenses as administrative costs.

Although 38 claims over five years for Virginia is a relatively small number, the problem is not the frequency but the amount of claims in relation to premiums paid. In 1984, at the beginning of the liability crisis, day care centers in Virginia only paid $62, 956 in premiums. If one large claim does not eliminate any chance for profit, then even just a few small claims (13 in this case) are enough to result in an extremely high loss ratio. And while the majority of day care operators rightfully assert that they have never filed a claim, day care is written as a class. The statistics indicate that as a group, the premiums paid for day care coverage are relatively small, and because there have been liability claims, high loss ratios have resulted for the industry in Virginia and nationwide.

Furthermore, since many policies cover medical expenses as well, the number of accident claims also has an effect. In the provider survey, day care providers were asked if they had filed an insurance claim within the past year. Thirty percent of the centers responded that they had, in fact, had some kind of a claim. While most of these claims were for medical or property damage, the potential for liability claims resulting from these accidents is ever present.

Child care advocates and industry officials both agree, however, that the information cannot accurately represent the whole situation. The ISO data excludes family day care providers who are insured through homeowners policies, and employer-sponsored child care facilities, or facilities housed within a larger organization under an umbrella policy. In addition, much of day care is written in the surplus lines market and under current regulatory mechanisms, these writers do not report their data to a statistical agent. Most insurance companies do not seem to have specific figures on claims data in child care. All of these factors combined give day care providers little assistance in understanding the reasoning behind the insurance problem they face.

## Effects of Liability Crisis on Day Care

The day care industry is imploring the public to understand the dilemma which exists in the day care field with regard to the consequences of increased operating costs. Almost three-quarters of the family homes responding to the survey reported that they serve families with incomes below $30,000 while more than two-thirds of the day care centers who responded estimated that the average salary of their families is below that figure. According to the Virginia Day Care Advisory Council, current cost of day care figures for Virginia vary from approximately $45.00

## FIGURE 1

### Nationwide ISO Claims Data

General Liability Insurance
Day Nurseries (Class 82115)
Monoline and Package Business

| Policy Year Ending | Total Limits Earned Premiums | Developed Basic Limits Inc. Losses | Developed Excess Limits Inc. Losses | Number of Claims | T/L Loss Ratio |
|---|---|---|---|---|---|
| 31-Dec-80 | $1,785,529 | $1,013,414 | $ 268,671 | 254 | 0.718 |
| 31-Dec-81 | $2,581,645 | $1,199,095 | $1,139,122 | 336 | 0.906 |
| 31-Dec-82 | $3,321,139 | $42,026,196 | $1,597,703 | 462 | 1.091 |
| 31-Dec-83 | $4,016,915 | $3,073,908 | $2,430,769 | 612 | 1.370 |
| 31-Dec-84 | $4,586,601 | $4,452,400 | $3,331,254 | 840 | 1.697 |
| Total | $16,291,829 | $11,765,013 | $8,767,519 | 2,504 | 1.260 |

## FIGURE 2

### Virginia ISO Claims Data

General Liability Insurance
Day Nurseries (Class 82115)
Monoline and Package Business

| Policy Year Ending | Total Limits Earned Premiums | Developed Basic Limits Inc. Losses | Developed Excess Limits Inc. Losses | Number of Claims | T/L Loss Ratio |
|---|---|---|---|---|---|
| 31-Dec-80 | $ 15,395 | $ 20,003 | $ 0 | 3 | 1.299 |
| 31-Dec-81 | $ 24,820 | $ 5,346 | $ 0 | 4 | 0.215 |
| 31-Dec-82 | $ 46,394 | $ 60,886 | $ 89,575 | 10 | 3.243 |
| 31-Dec-83 | $ 63,710 | $ 71,635 | $171,072 | 13 | 3.810 |
| 31-Dec-84 | $ 62,956 | $ 21,396 | $ 0 | 8 | 0.340 |
| Total | $213,275 | $179,266 | $260,647 | 38 | 2.063 |

per week to $85.00 per week for one preschool child. Costs for infant care are much higher, and, of course, families with two or more children are faced with weekly bills of close to $200 for child care.

Unfortunately, some of the insurance companies' attempts to lessen their own financial risks have increased the risk for the day care industry. While the rise in insurance premiums has weakened many day care facilities' financial structure, the exclusions for child abuse have served to seriously intensify the whole day care industry's public image problems. Only 12% of the family day care homes responding to the survey reported that their day care policy had a sexual abuse exclusion; 27% of the day care center providers have the exclusion. The trend of company practices, however, indicate that more of these exclusions will appear as policies are renewed. One of the biggest concerns day care providers expressed about this practice is the fact that the exclusions include allegations of child abuse so that even if a day care staff member is unjustly accused, costly legal expense to prove innocence must be paid by the center or the individual staff member.

Two negative effects for day care providers have occurred. On one hand, churches and landlords who provide space for child care programs are reluctant to do so. The notoriety given by the press to the few child abuse incidents has made not only landlords but also board members of organizations sponsoring day care and volunteers more reluctant to have anything to do with day care. On the other hand, day care providers maintain that they are "sitting ducks" for parents and others who are, at best, in a super sensitive state over the possibility of mistreatment of their children and, at worst, are "mentally ill or avaricious."

An additional problem caused by the liability insurance crisis is that potential day care providers are being discouraged from entering the field. Testimony was offered by one new day care operator who was attempting to start a new facility. One of the first things she did was to look for insurance to determine what the price would be. Her agent found insurance, and she started paying a basic premium to satisfy the bank's requirements until the center opened. Plans proceeded for the new day care center but when the time came to close on the bank loan a few months later, she found that she no longer had insurance. She was in the process of building and the company cancelled. Three other companies indicated they might insure the day care operation, quoting premiums from $10,000 to $18,000. Although this provider finally found insurance for a premium between $8,000 and $12,000, considerable thought was given to whether this venture was really worth entering.

One reason insurance for new day care centers has been very hard to find is because some insurance companies are requiring that the owner of the center has at least three years experience before the company will write insurance for that center. Virginia licensing regulations, on the other hand, only require that directors and assistant directors of day care centers have either a certain number of hours of college credit in early child education or a related field and one year of programmatic experience, or a certain number of credits in another field and two years experience. Licensing does not require experience for day care center owners if they are not acting as director or administrator.

The increased costs and decreasing availability of liability insurance is affecting the nature of leadership in day care. Directors and officers of corporations sponsoring day care programs are placed in the position of risking personal financial losses in the event of claims against the day care facility. As a result, fewer qualified persons are willing to serve in such positions. And those who choose to take the risk have reason to exercise increased caution in their decision making roles.

Another concern of some day care providers is that the insurance industry is establishing conditions and standards for insurability that are far in excess of standards providers must meet to be licensed by the state, thus driving operating costs higher. Insurance companies' efforts at risk management sometimes require a day care facility to hire additional staff or to restructure the facilities to meet increased safety criteria in order to obtain insurance. One company, for example, has agreed to insure centers affiliated with the National Association for the Education of Young Children (NAEYC), and is using NAEYC's criteria for exemplary centers as a scale to measure a center's liability risk. The standards list model staff qualifications that, for instance, require a teacher to have a bachelor's degree in early childhood education/child development and staff/child ratios of 1 : 8 to 1:10 for four-year-olds. This ratio is high by many state standards including Virginia which requires one staff person for every 12 children for four-year-olds.

A major surplus lines carrier that underwrites more than 750 family day care homes and child care centers across the nation has also set certain criteria. This company requires the facility to be inspected by the local health department and offers its lowest premiums to providers with 1 : 1 staff/child ratios for children one year of age or younger. Virginia licensure requirements include one staff person for every four children 16 months or younger. The company also looks at the hiring practices of child care providers to determine whether background checks are being conducted and, for family day care homes, asks what other residents live in the provider's house and if any large pets roam free. All of these criteria help to determine what kind of risk the facility is and helps the company to set appropriate premium rates.

Another company, which offers coverage only through the Virginia Market Assistance Plan, requires that a center be licensed by the state and that all employees have certified first-aid training. The company's required child/teacher ratio is 1:4 for children under three,; 1 : 6 for 3 to 5 year olds, and 1 : 12 for children over five (as compared to Virginia licensing requirements of 1 : 4 for infants, 1 : 5 for children 16 months to two years old, 1 : 10 for children two to four years old, 1 : 12 for children four years to the age of eligibility to attend school, and 1 : 20 for children of school age.

The expense of these increased standards is seen to be prohibitive. One family home provider reported having to add a circular driveway to her home so that children could get in and out of cars more safely. In terms of hiring additional staff, the day care field is labor intensive because a relatively low staff to child ratio is needed to care for young children. Day care providers claim that, as it already is, they are unable to pay adequate wages to the existing staff members. For some, hiring even more is an impossibility. The Virginia Department for Children's 1986 State Plan for Child Day Care cited day care teachers' salaries for a full year as averaging just over $9,000 while teachers' aides are paid less than $7,000. And day care providers are quick to note that if fees for child attendance are raised in order to increase salaries, hire additional staff, or remodel the physical facilities, then parents would be unable to afford the services.

In spite of their concerns, many day care providers testified at the public meetings that they had no choice but to raise fees this year. Each year they find they have to commit more money for insurance premiums rather than use this money for classroom materials and staff development that are necessary to insure a quality program. Some day care facilities have stopped providing transportation and have cancelled field trips. Day care providers maintain that if the costs keep spiraling, the children will face fewer supplies, less nutritious meals, shabbier surroundings, poorly qualified staff - or maybe no child care at all.

Programs that cannot budget the liability insurance premium increase may have to cease operations, thus leaving the children to be placed into unlicensed, and perhaps lower-quality homes and centers operating without protective features. In our provider survey, 10% of the facilities indicated that they were considering closing, and the tremendous need for day care services makes any loss significant.

Most of the day care providers who attended the public meetings indicated their determination to attempt to bear the cost and continue in their profession. One provider stated: "I am going to try to hold out because I am now providing for 45 children on a daily basis whose parents are, in most instances, low income or state funded. I find it very difficult to raise tuition costs because of things like insurance going up and state standards changing to the point where I can't provide the type of services that I am trying to provide or trying to meet the financial needs of the center operation itself. The overhead is great. The first two years I was in business, my insurance ran me in the neighborhood of $1300. This year it rose to $2973. Out of the 40 children attending my center, 23 are through Social Services so I cannot pass on the increased cost to their parents and its unfair to have to pass all of it on to those who are trying to pay the full tuition."

Another provider queried about the prospect of closing her center. "If I have to cancel my insurance, what will happen to those children in the area that I am in? One half of my center's parents are ADC and these parents are in school trying to finish their education. A lot of these parents have two and three children. These parents would have to quit going to school and get back on ADC. And most of my parents are going to school. They are getting an education. They are getting jobs. So this is my concern."

## OPTIONS TO BE CONSIDERED

The House Joint Resolution No. 93 charged the State Corporation Commission to make recommendations which may result in assisting insurance companies to make coverage more available and to reduce liability insurance premiums. The opinions gathered during the course of the study varied widely over the measures needed to bring down liability insurance premiums for the day care industry. Comments ranged from the belief that the child care provider is a powerless victim of the financial cycles of the insurance industry, to suggestions that providers should monitor each other's programs and lobby state officials to set limits on claims awards.

The Reagan administration has announced that tort reform is necessary to bring down the rates for liability insurance in general and has made a number of recommendations to achieve reform at the federal level. At the state level, the Virginia General Assembly is examining the overall issue for the Commonwealth through a joint subcommittee charged by Senate Joint Resolution No. 22 to "study (i) the causes, effects, and possible solutions to the problems experienced by political subdivisions, businesses and citizens of the Commonwealth in obtaining adequate and affordable liability and related insurance coverage and (ii) the tort reparations system, including a review of the ability of that system to ensure an equitable method of determining liability and assessing damages, and the impact of that system on the cost and availability of liability insurance, and to make recommendations on methods for improving the liability insurance system and the tort reparations system as they may affect the public interest." Much of what SJR 22 will accomplish is intended to assist all types of entities in need of liability insurance, including day care providers. HJR 93 was passed as a supplement to the legislative committee study and will therefore not duplicate the efforts of SJR 22 but instead supportively point to its final recommendations.

This study also did not attempt to address the debate between tort versus insurance reform. Most will probably agree that a little of both types of reform are needed, but that there are no quick or easy solutions to the insurance problems of day care or any other service or industry being hit with budget-shattering premium increases. There are, however, options that could be considered as potential measures to ease the liability insurance problems and which may have positive effects on the overall day care industry. Some of these options have already been attempted in Virginia but have had interesting effects on the problem. Most of these possibilities go beyond the charge of this study but are presented for consideration of the overall needs of the day care industry. These options can be divided into those intended to help with the availability issue and those intended to address the problem of affordability.

Some options that might assist in making insurance more available for day care facilities are:

Market Assistance Programs
A market assistance program is a voluntary arrangement with insurance companies created to assist commercial insurance buyers in obtaining difficult to place commercial lines of liability insurance. Market assistance plans are limited to the insurance availability problem and will not assist any risk that can obtain coverage and is merely seeking a reduced price. In most

states that have market assistance plans, including Virginia, these plans have either met with great success in terms of a high placement rate for day care providers, or they have received few applications in the first place. Both situations are viewed as indications that it is the cost of liability insurance, not the availability, that is the major problem.

Joint Underwriting Association

Another avenue to securing insurance, while not guaranteeing its affordability, is to form a Joint Underwriting Association (JUA). Generally, laws that create JUAs earmark a group of licensed carriers in the state (such as property and casualty companies) and require them to share in the costs of insuring a specified group of risks. In Virginia, a JUA has been recently activated for medical malpractice insurance and in this case is designed to be self-supporting with insurer financial contributions being temporary. Premiums paid by the group participants are set at a rate that is intended to be able to cover claims. If claims exceed the available funds, the group participants are assessed an amount to cover the costs. One disadvantage is the relatively small number of day care facilities available to form such a group. Since participants in a JUA covering child care may be compelled to insure child care providers who are considered bad risks and cannot find insurance elsewhere, one large claim for a self-supporting JUA would cost each participant (i.e., each day care provider) a great deal of money.

Pooling

Child care providers nationwide could band together to set up their own insurance company or self insurance pool and establish their own reserves to cover losses. The federal Risk Retention Act of 1986 essentially allows industry groups to form small insurance companies which are subject to relatively little state regulation. Before the Product Risk Retention Act of 1981 was modified by this recent amendment, associations forming captive insurance companies were severely restricted in the types of insurance they could offer. Now liability risks can form risk retention groups to self insure for all types of commercial liability.

Start-up funds for a child care coalition are estimated at about $20 million which is thought to be prohibitive to child care providers. On the other hand, while child care providers might not self insure on their own, they might be able to band together with elementary school teachers and foster care providers to self-insure.

Another option to be considered is the suggestion that child care providers band together to be able to purchase group insurance. But group insurance brings its own set of problems since companies would have to take the good facilities with the bad when estimating risks and determining premiums.

Limits on Policy Cancellations, Nonrenewals, and Rate Increases

Another possibility is to pass legislation that would limit an insurance company's ability to cancel or nonrenew a liability insurance policy. A 1986 bill that was passed by the Virginia legislation provides that insurers must give a 45-day notification that a commercial policy is being cancelled or nonrenewed.

Some states have taken a harder line. New Jersey, for instance, passed an emergency moratorium on cancellations or nonrenewals. The regulation was then adopted as a permanent rule under which insurance companies can not cancel in midterm or refuse to renew a commercial policy except for certain reasons such as non-payment of premium. Virginia passed legislation in 1986 that limits the right of an insurer (beyond the 45-day notification) to non-renew or terminate coverage. Although this legislation was restricted to vanpools, the result is important because many insurance companies reacted by cancelling or nonrenewing coverage before the law took effect on July 1. Insurance companies have demonstrated that they do not want to be forced to write coverage or have rates imposed on them that they believe will affect their ability to remain solvent.

Florida and Maryland stand out as two states that have forced the insurance industry to accept child care as a risk, and both have experienced repercussions. In Maryland, insurance companies that provide homeowners insurance to family day care providers are now required to extend liability coverage to that child care business itself. The legislation requires companies to provide at least $300,000 worth of liability coverage for the child care business. In addition, a family day care home provider's auto insurance company would have to extend a minimum of $20,000 in transportation coverage related to family day care business. Although the effect of the legislation is still not known, the Maryland Committee for Children reported at least one phone call in which a family day care home provider said her homeowner's insurance policy was cancelled after the bill passed.

Florida has become the first state to require insurance companies to roll back their premiums to January 1984 levels and require justification for any increase above that level. No other state has done that since the late 1960s when companies were ordered to bring down auto insurance rates. The legislation also requires a 45-day mandatory advance notification for policy cancellations or non-renewals. About 270 companies and three insurance trade groups then sued in a state circuit court, arguing that the law was unconstitutional. Although the law was upheld for the most part, the insurance companies will probably appeal. Since the law was passed in June, many of the companies have stopped writing new business in Florida. Under the law, commercial customers are to get credit for 40% of the premiums they owe for the final three months of 1986. The circuit court judge struck down the premium credit for policies issued before July 1, the law's effective date; however, he upheld the premium credit for new policies and renewals. A chief facet of the law is that the commissioner will treat 1984 as a base year in ruling on future rate proposals. In effect, the burden is on individual companies to justify increases in 1987 rates above the levels in effect on January 1, 1984. Practically every company has filed to keep premiums above those prevailing in 1984. A similar solution in West Virginia resulted in an emergency session of the state's legislature to reverse some of the pricing and underwriting restrictions imposed on medical malpractice insurers after five major companies threatened to withdraw from the market in that state.

Some options that might assist in making insurance more affordable for day care facilities are:

Tort Reform

Several states have attempted to deal with the affordability issue by passing legislation limiting jury awards. The intention of tort reform is to help insurance companies be able to estimate potential risk by placing a limit on it. Maryland now limits damages to $350,000 for non-economic loss. Florida placed a limit of $450,000 on jury awards for non-economic damgages and also placed restrictions over the doctrine of joint and several liability. Alaska passed a $500,000 cap on economic damages and limited the liability of directors and officers of nonprofit organizations unless the act or omission constituted gross negligence. Colorado, and California have followed suit by legislating tort reform which includes limits on non-ecomonic damages and modifications of the concept of joint and several liability. North Carolina places sanctions on persons making frivolous lawsuits, as does Oklahoma.

Hawaii recently passed a comprehensive new tort reform measure in special session to address the problem of liability insurance availability at reasonable cost. With this new legislation, 1) insurance policies shall not be construed to include coverage for punitive damages unless the policy specifically includes such coverage; 2) attorneys' fees in all tort actions are limited to a reasonable amount approved by the court; 3) the rule requiring joint and several liability was modified so that a party found liable is responsible only for the share of damages awarded because of his negligence, if he was less than 25 percent at fault; 4) a limit of $275,000 was placed on non-economic damages; 5) a provision was made for mandatory, non-binding arbitration with the intent of reducing the number of cases that go through the courts. In response to these tort reform provisions that are supposed to reduce insurance company expenses, Hawaii now requires a 10 percent reduction in premiums for commercial liability policies for the next year, with further reductions effective in future years.

The effect of any of these tort reform measures is still too early to determine. Many other states are keeping pace with Virginia and are studying the problem with the intention of making recommendations at the next meeting of their respective state legislature.

Increased Claims Data

Some day care providers have suggested that legislative reform is needed to mandate that the insurance industry make available specific information on child care losses. The intention is to be able to find what data are available regarding insurance claims and actual losses in day care. While day care is perceived as a high risk, the anecdotal data from the public meeting testimonies suggest that claims are infrequent and for low amounts. Company data for Virginia appear to indicate differently. A more complete compilation of claims data would give insurance companies and day care providers a more realistic view of the kinds of claims that arise in day care and how much is spent paying those claims.

An alternative approach to requiring insurance companies to gather data specific to day care might be to establish a system for reporting all claims by day care providers to the Virginia Department for Children. Included in the information could be cause of loss, the date of loss, and the amount paid. Additional information could include the number of years the center has been in operation, the number of past claims, the number of children and the number of staff. Losses on homeowners policies should be included since this information is particularly difficult for insurance companies to separate from other general homeowners claims.

Tax Advantages

Study might be given to the possibility of lowering the premium taxes for insurance companies that write day care liability insurance. Tax incentives for businesses that sponsor day care facilities might also be an option for review.

Claims-Made Policies

While admitted insurance companies are shying away from the child care market until changes are made to lower their risks, surplus lines companies have been providing coverage for day care facilities, albeit at a high premium. Many insurance industry representatives believe that day care is a specialty line and should be left to the surplus lines market. One of the reasons is because until recently, only surplus lines carriers could offer day care insurance in Virginia on claims-made forms. Claims-made forms have been suggested as a means to assist with both the availability and affordability problems for liability risks. From the perspective of insurance companies, the claims-made form is one way to respond to the problem of unknown potential for claims filed due to accidents years after the child has left a day care program. Now that the ISO claims-made form has been approved for use in Virginia effective March 1, 1987, more admitted companies may be willing to offer day care coverage.

The approval of the ISO claims-made form may make liability insurance for day care more available and perhaps more affordable in the immediate future. In fact, one principal provider of day care coverage will only market their policies in states where claims-made forms have been approved. But the long term effects could be troublesome because of the nature of day care claims. A claims-made policy usually requires that the policy is in force when the claim is filed. An occurrence policy, on the other hand, generally covers claims filed years after a policy has expired as long as the accident or injury occurred when the policy was in effect. This is an important distinction to child care providers. Since a suit can be brought on behalf of a child until that child turns eighteen years of age and then can be filed by the child as an adult, a day care provider may very possibly be sued after the day care facility no longer exists. And while some claims-made policies do offer limited coverage beyond the life of the policy, the expense is often prohibitive.

Increase Standards for Day Care

Several insurance companies responding to the company survey (Appendix B) suggested that tighter quality control in day care programs would help companies better assess their risks and at the same time reduce the chance of loss, thereby reducing potential risk, improving overall experience, and finally reducing premiums. Increased standards would have to have corresponding state monitoring regulations to assure that the standards are being met which would require increasing the Department of Social Services staff of licensing specialists. Some companies agreed that exemptions from licensure for some day care facilities should be eliminated so that all facilities would have to meet minimum standards. Many insurance companies indicated that child care providers should also tighten up on the hiring of their staff.

These company standards, calling for low staff/ child ratios, adequate teacher training and safe facilities, are difficult for many child care providers to reach, partially because of the expense involved in upgrading operations. Some child care advocates, however, actually maintain that while the insurance crisis may have hurt some individual businesses, it may serve to raise the overall quality of child care programs nationwide by setting performance standards that are higher, in most cases, than minimum operating requirements imposed by the state.

The problem with increasing the standards for day care facilities goes back to the issue of affordable day care. Child day care is labor intensive -workers salaries are at least 50% of any day care center's budget and many go even higher. The cost of care rises dramatically with the addition of staff. When the insurance industry attempts to increase the quality of day care services by increasing the staff to child ratio, the cost to consumers must be increased. When costs are raised, some parents are able to pay, others are not.

Licensing of all Day Care Facility Employees/ Criminal Records Check

A related option mentioned by many respondants to the company survey is to require all employees of a day care facility to be licensed. Again, such measures are viewed as attempts to make day care a better risk. New Jersey recently passed a bill relating to the staff of day care centers providing that anyone who has direct contact with the children enrolled in the center shall obtain a license. As part of the application process, each employee would be required to undergo a psychiatric examination to determine the employee's mental competency. The employee would also have to undergo a criminal history record background investigation, including a fingerprint check.

A policy of mandatory criminal background checks for selected child care workers was adopted by the Virginia General Assembly in 1985. Under this provision, owners and employees of child care centers caring for 10 or more children are subject to background checks. The screening process only identifies convictions of "criminal sexual assault" and "indecent liberties with a child" that have occurred in Virginia. Last year, the General Assembly undertook a study to evaluate the background check procedure. Recommendations from this study will include a provision for background checks to be expanded to cover not only child care centers but also child placing agencies and family day care providers. Consideration is also being given to expanding the types of crimes that should be identified for people working with children, as well as introducing a disclosure statement for teachers.

Amend Day Care Licensing Insurance Requirement

Both California and Florida have reduced the amount of liability insurance required of day care facilities in order to be licensed. As is the case in Virginia, Florida just raised the amount of coverage needed for licensure. Due to the many complaints received on affordability, availability, and severe underwriting restrictions, the requirement was repealed a year later. Many of Virginia's day care providers faced similar problems when the Virginia licensure laws were changed.

Public Assistance

The Governing Board of the National Association for the Education of Young Children approved a position statement on the liability insurance crisis. Among the reforms supported by this group is the creation of a state subsidy to provide assistance to early childhood programs, particularly those serving predominately low-income families, so that the cost of day care does not become prohibitive and quality does not deteriorate as insurance costs rise. In Virginia, the day care facilities seemingly facing the greatest affordability problems are those that take children from low-income families. Such facilities rely on public money to pay tuition for these children.

In New York, a state grant of $60,000 has been made available to help offset skyrocketing liability insurance for more than two dozen not-for-profit Westchester day care centers. It is a one-time grant that is considered by the day care industry to be helpful but will not solve the systemic problem. The money will be used to fund 31% of the liability insurance costs for 26 not-for-profit centers. North Carolina has attempted to promote private involvement into the cost of day care by including child care as an integral part of the state's economic development package. They have been providing businesses with brochures, booklets, and other forms of support and help in starting child care centers or care benefit packages for employees.

## CONCLUSION

The State Corporation Commission was requested to study the nature of the liability insurance problems being faced by the day care industry and to offer recommendations that could assist in making insurance more available and more affordable. According to the information gathered through this study, family day care homes continue to face obstacles in finding insurance to cover their operations, while day care center providers struggle to absorb the increased costs of the insurance that has been found. These problems have exacerbated the existing fragile and fragmented state of the day care field and are causing an overall crisis for the industry.

When the family home providers responding to the study survey were asked how they would rate being able to obtain and afford liability insurance as a problem, 29% rated the issue as their number one concern in relation to their operation; an additional 29% placed the problem within their top three concerns. Of the day care center providers responding to the survey, 26% rated the problem as their top concern with an additional 39% placing the issue within their top three concerns.

The effects of the liability insurance crisis has hampered the day care industry's attempts to grow and meet the expanding needs of Virginia's working parents. Yet, in spite of the problems being faced, many day care providers appear determined to continue in their field. Only 14% of the family home day care providers indicated in their survey response that they are considering closing because of the cost of insurance or because insurance is unavailable for them. On the other hand, 5% of the day care center providers indicated they were considering closing because of the cost of insurance but 10% suggested that the inability to find adequate insurance coverage was pushing them to consider closing. And while the overall liability crisis appears to be easing, the future for high risk insurance coverage - such as for day care - is still uncertain at this time. A question posed by one day care provider testifying at a public meeting reflected the concerns of most who participated in the study: "We do not know what 1987 will bring, but it is a deep concern and a frightening prospect. We must have coverage to be licensed, but will it be there and at what cost?"

Insurance is frequently viewed as a socially-necessary product, essential to personal economic stability. The terms on which insurance is sold should be fair to the policyholder; that is, the insured should not pay more for a premium than the coverage is worth. Yet, since the purpose of insurance is to convert unpredictable risks into predictable costs, and thereby provide a measure of security for policyholders, the insurance product must be reliable. In other words, the insurance company must remain solvent and be financially able to pay claims in accordance with the terms of the policy in question. The balance between the public's need for insurance and the insurance industry's right to stay in business is sometimes precarious. In the case of day care, the unstable nature of the field has added to the dilemma. Specific recommendations toward resolving the day care industry's problems go beyond simple insurance mechanisms and beyond the scope of the study. The efforts herein focused on an overall review of the extent of the situation. Some possible options have been offered for consideration so that efforts aimed at resolving the current liability insurance problem for day care in context of the overall nature of the day care field can take all considerations into account.

# APPENDIX A
# DAY CARE PROVIDER SURVEY RESULTS

## SUMMARY OF RESULTS

A survey was mailed to all day care facilities licensed by the Department of Social Services as of August, 1986. At that time, 280 family homes and 890 day care centers were licensed to provide day care services. Three-hundred-and-fifty-two surveys were completed resulting in a 30% overall rate of return. Divided into categories, 51 family homes (18% of those licensed) and 301 day care centers (34% of those licensed) responded to the survey. The low rate of return for family homes makes any attempt to generalize the results to the total population of family home providers difficult. The 34% of the day care centers, however, is considered statistically adequate to be representative of that segment of the day care industry. These results should be reviewed in that light. In addition, answers provided in the survey must be considered in the context of a dynamic, still-changing, set of events. Many providers indicated that they had not received their insurance renewal for 1986 at the time of the survey and were uncertain of their immediate future concerns.

The highlights of the family home survey results are:

- 37% of licensed family homes who responded had no insurance;
- 20% had insurance but were cancelled within the past year;
- 16% had rate increases at the last renewal of more than 50% over the previous year;
- 2% had an exclusion for child molestation;
- 63% had never filed any kind of insurance claim for their day care operation;
- 29% rated the insurance problem as their top concern, and another 29% rated it within their three highest concerns;
- 14% are considering closing because insurance is unavailable; and
- 14% are considering closing because insurance is unaffordable.

The highlights of the day care center survey results are:

- 23% have experienced cancellation or nonrenewal of their insurance within the past year;
- 27% had rate increases at the last renewal of more than 100% over the previous year;
- 27% had an exclusion for child molestation;
- 69% had never filed any kind of insurance claim for their day care operation;
- 26% rated the insurance problem as their top concern, and another 39% rated it within their three highest concerns;
- 5% are considering closing because insurance is unavailable;
- 10% are considering closing because insurance is unaffordable.

Information from the surveys are reported in table form using percentage of total response.

## Table 1.

### DAY CARE PROVIDER SURVEY RESULTS FOR

### FAMILY DAY CARE HOMES

### (N=51)

| Questions | Responses | | | | | |
|---|---|---|---|---|---|---|
| | 1-3 | 4-9 | 10-15 | 16-25 | 25-50 | 50+ |
| 1. How many children are in your facility? | 2% | 98% | - | - | - | - |

| | non profit | profit |
|---|---|---|
| 2. [illegible]t is the tax [illegible]us of your [illegible]acility? | 18% | 82% |

| | no | yes |
|---|---|---|
| 3. Do you receive local, state or federal funding? | 78% | 22% |

| | all ages | infant | infant to five | two to five | two to school | school aged |
|---|---|---|---|---|---|---|
| 4. What age group do you serve? | 39% | 12% | 18% | 22% | 9% | - |

| | under $15,000 | $15,000-$30,000 | $30,000-$45,000 | $45,000+ | no response |
|---|---|---|---|---|---|
| 5. What is the average family income of the parents you serve? | 12% | 61% | 18% | - | 9% |

| | 0-3 years | 4-6 years | 7-10 years | 11+ years |
|---|---|---|---|---|
| 6. How many years has your facility been in operation? | 41% | 21% | 14% | 24% |

| | none | CGL | business auto | professional liability | homeowners rider |
|---|---|---|---|---|---|
| *7. What kind of insurance does your day care program have? | 39% | 20% | 8% | 12% | 31% |

| | no | yes | no response |
|---|---|---|---|
| 8. Has your insurance been cancelled or nonrenewed within the last three years? | 57% | 21.5% | 21.5% |

*Those family homes that have insurance may have more than one kind so the numbers exceed 100%.

| | 0-50% | 51-100% | 101-150% | 151-200% | 201-250% | 251-300% | 300%+ | [illegible] |
|---|---|---|---|---|---|---|---|---|
| 9. What percentage did your insurance premiums increase the last time you renewed? | 43% | 10% | - | 4% | - | - | 2% | 4 |

| | no | yes | no response |
|---|---|---|---|
| 10. Was the extent of your coverage reduced the last time you renewed? | 63% | 4% | 33% |

| | no | yes | no response |
|---|---|---|---|
| 11. Does your liability insurance policy have an exclusion for court costs arising from allegations of child abuse? | 45% | 12% | 43% |

| | no | yes | no response |
|---|---|---|---|
| 12. Have you filed an insurance claim within the last five years? | 63% | 14% | 23% |

| | 1(highest) | 2(top 3) | 3(top 10) | 4(concern) | 5(not concern) |
|---|---|---|---|---|---|
| 13. On a scale of 1 to 5, how would you rate being able to obtain and afford liability insurance as a problem for your facility? | 29% | 29% | 16% | 18% | 8% |

| | no | yes |
|---|---|---|
| 14. Are you considering closing your day care facility because liability insurance is completely unavailable for your program? | 86% | 14% |

| | no | yes |
|---|---|---|
| 15. Are you considering closing your day care facility because of the cost of liability insurance? | 86% | 14% |

## Table 2.

## DAY CARE PROVIDER SURVEY RESULTS

## FOR DAY CARE CENTERS

## (N=301)

| Questions | Responses | | | | | |
|---|---|---|---|---|---|---|
| | 1-3 | 4-9 | 10-15 | 16-25 | 25-50 | 50+ |
| 1. How many children are in your facility? | 6% | 1% | 1% | 11% | 26% | 55% |

| | non profit | profit |
|---|---|---|
| 2. What is the tax status of your facility? | 46% | 54% |

| | no | yes |
|---|---|---|
| 3. Do you receive local, state or federal funding? | 71% | 29% |

| | all ages | infant | infant to five | two to five | two to school | school aged |
|---|---|---|---|---|---|---|
| 4. What age group do you serve? | 26% | 1% | 8% | 27% | 34% | 4% |

| | under $15,000 | $15,000-$30,000 | $30,000-$45,000 | $45,000+ | no response |
|---|---|---|---|---|---|
| 5. What is the average family income of the parents you serve? | 25% | 41% | 19% | 5% | 10% |

| | 0-3 years | 4-6 years | 7-10 years | 11+ years |
|---|---|---|---|---|
| 6. How many years has your facility been in operation? | 28% | 9% | 16% | 47% |

| | no | yes |
|---|---|---|
| 7. Has your insurance been cancelled or nonrenewed within the last three years? | 77% | 23% |

| | 0-100% | 101-200% | 201-300% | 300%+ | no response |
|---|---|---|---|---|---|
| 8. What percentage did your insurance premiums increase the last time you renewed? | 70% | 10% | 7% | 10% | 3% |

| | no | yes | no response |
|---|---|---|---|
| 9. Was the extent of your coverge reduced the last time you renewed? | 74% | 20% | 6% |

| | no | yes | no response |
|---|---|---|---|
| 10. Does your liability insurance policy have an exclusion for court costs arising from allegations of child abuse? | 61% | 27% | 12% |

| | no | yes |
|---|---|---|
| 11. Have you filed an insurance claim within the last five years? | 69% | 31% |

| | 1(highest) | 2(top 3) | 3(top 10) | 4(concern) | 5(not concern) |
|---|---|---|---|---|---|
| 12. On a scale of 1 to 5, how would you rate being able to obtain and afford liability insurance as a problem for your facility? | 26% | 39% | 15% | 13% | 7% |

| | no | yes |
|---|---|---|
| 13. Are you considering closing your day care facility because liability insurance is completely unavailable for your program? | 95% | 5% |

| | no | yes |
|---|---|---|
| 14. Are you considering closing your day care facility because of the cost of liability insurance? | 90% | 10% |

# APPENDIX B
# COMPANY SURVEY RESULTS

## SUMMARY OF RESULTS

A survey was mailed to all property and casualty insurance companies licensed in Virginia to identify those writing day care coverage. Of the 68% of the companies that responded, 38 offer coverage for day care operations. Of that 38, 30 companies offer coverage for commercial day care centers and 13 offer coverage for family day care homes.

Of the 30 that offer commercial coverage, 9 indicated that they are not accepting new business and 14 will only write coverage if the center is part of a larger risk such as a church.

Of the 13 that offer coverage for family homes, 1 is limited to directors and officers liability only, 1 limits incidental occupancy to 2 children under a homeowners policy, 1 offers coverage for up to 6 children but prefers no new business, and ten use the ISO or similar endorsement to the homeowners policy covering up to 3 children in the home.

As with the provider survey, the information gained from the company survey must be viewed in the context of a dynamic situation. Since the time of the survey, at least one company that only covered family homes with no more than three children has expanded coverage to six children in the home. As the market eases, more companies may feel comfortable with the day care risk. The results of this survey have been reported in the form of comments made by insurance company representatives to specific questions aimed at obtaining the company perspective of the day care insurance crisis.

## COMPANY SURVEY RESPONSES

(N = 38)

1. **Do you think doing away with licensing exemptions for small family day care homes and church-sponsored centers and instead requiring all day care facilities to be licensed would help make the day care risk more acceptable to your company?**

Yes - 20 (53%)
No - 11 (29%)
N/A - 7 (18%)

COMMENTS:

- It might have an adverse effect on availability of day care but would surely raise standards provided there was sufficient compliance monitoring.
- The fact that a day care facility is licensed does not by itself make the risk more acceptable. Professional management and enforcement of rigid licensing standards are more of a factor
- Any standardization would be helpful
- While we are not specifically familiar with Virginia's laws on this, our feeling is that properly licensed facilities will have better overall risk management
- Currently, we don't check to see if the home day care is licensed; thus, even if they are required to be licensed it wouldn't affect the risk
- We do not support government infringement in the church area
- All persons working with children and physical condition of all day care centers should be thoroughly checked on a continuous basis
- Operator background checks are essential
- Requiring both family facilities and church sponsored facilities to meet state licensing requirements would improve the quality of such risks and give the insurance companies assurance that a minimum requirement is being met
- Would provide standards for all types of facilities and help assure quality care for the children

- Not only should the facility be licensed but so should every individual seeking employment in such a facility. Licensing should include complete background checks, fingerprints, and criminal records checked. This would apply even to janitorial personnel

- Providing the state committed the resources needed to properly police operators for compliance with standards through onsight inspections

- Whatever action can be taken to improve the quality of management and operation of the facilities would be beneficial. Along with licensing, must be the duty to inspect. Authority to close where minimum standards are not met and to provide assistance and educational material to improve the quality of care for all facilities

- Professional qualifications of all staff is a key consideration. Licensing and state inspections should help reduce normal health exposures

- We believe this coverage belongs in a specialty market

- We are currently writing those exempt classes. While good licensing and enforcement should improve overall quality, it will have little impact on good facilities

- Licensing or lack thereof does not change the exposure; condition of the premises and nature of operations affect acceptability

- Licensing requirements are of little effect unless the state has the resources to inspect and monitor compliance on an on-going basis

- Licensing of the centers and of all employees would help

2. **If quality control standards that are above the current minimum licensing standards are mandated for day care in Virginia, do you think your company would be willing to open a dialogue with the day care industry through the Bureau of Insurance to discuss lowering the premium structure for day care liability insurance?**

Yes - 3 (8%)
No - 27 (71%)
N/A - 8 (21%)

COMMENTS:

- We have never been an active market for in-house day care or day care center liability insurance; we have no interest in cultivating these markets which historically have been serviced largely by specialty carriers.

- Quality control is extremely important but our statistics are based on the higher standards we have developed. Past experience does not warrant rate decreases. Our standards were developed in conjunction with the National Association for the Education of Young Children. We are certainly willing to meet with the day care industry

- We realize that it is socially imperative that liability insurance be affordable for child care centers. The keys are 1) defining affordability and 2) accurately predicting long tail loss costs

- Since this is an endorsement to our homeowners policy, the premium is based on the amount of liability and medical payments coverages. The premiums range from $15 - 32 and we don't feel that this is an excessive amount

- Our company has not increased premium significantly for this type of coverage; in view of increased public awareness of loss susceptibility, premium reduction does not appear warranted

- On a limited basis (yes)

- Rates are set usually on an industry-wide basis; certainly increased standards are a factor that should reduce or avoid claims and ultimately lower premiums.

- Licensing control standards are only one part of pricing formula - individual risk characteristics are rated, including health and safety features. If day care industry complies with all codes and standards, loss experience should improve, and therefore be reflected in the rates

- Possibly - if the extent of our liability can be established and meaningful controls are in place

- Our rates are not excessive. Higher quality control standards may help to increase market availability which will tend to moderate the rates.

- Lowering the premium structure will result from experience and should not be mandated by rule changes. Outside forces, such as juries, statutes, public reaction, all influence this industry. Mandated rate reductions at this time would only serve to reduce the number of companies willing to provide coverage

- Our few risks written develop minimal premiums and are an inadequate premium base by themselves to warrant reduction at this time. Industry figures and experience must be used at this time

- If loss experience improves, premiums will reflect it over time

- Our company uses ISO rates which are based on loss experience. Any strengthening of regulations should reduce losses and eventually result in premium savings

- Our present rates are quite reasonable; if quality control improves, the experience will ultimately lower rates

- Our understanding is that current market rates average about $1 per child per week - about the minimum needed to issue a policy

- The current premium structure is inadequate even with more stringent licensing requirements

3. **In your opinion, is there anything else that day care facilities can do to bring down the cost of liability insurance?**

COMMENTS:

- The Day Care industry and the state must take steps to ensure that those engaged in this pursuit are the true professional, qualified entities. The industry must police its ranks, the state must adopt rigid standards surrounding life-safety and qualification specifications and strictly enforce same

- 1) Providing or mandating major medical coverage for children; 2) Allowing for the best background checks on newly hired employees - sharing data with law enforcement and other states; 3) Careful supervision at recreational facilities used; 4) Keep neat records for the future

- 1) Reduce the degree of recreational facilities provided; 2) Improve the degree of supervision by lower child/attendant ratios; 3) Be more selective in hiring practice, re: past sex offenders

- Maintain highest possible standards and thoroughly check employees and procedures

- Employee background checks are essential

- Strict adherence to regulated guidelines regarding the procedures for doing background checks on all employed individuals at a day care center, as well as stipulated pick-up and drop-off procedures

- Quality control and customer relations create the reputation which is a key. Quality control entailing both adequate safeguards on the premises to protect the children, and high standards and background checks on all employees

- More stringent employee selection and training

- Thorough previous employment checks are very important and close supervision of all employees are mandatory to control costs

- 1) Adoption of exclusion and endorsements for physical and sexual abuse; 2) cap on liability; 3) compliance with licensing, safety and health code standards should reduce loss experience and cause reflection in rates

- Improve selectivity of hiring criteria. Maintain adequate supervision of staff. Accept exclusions for sexual abuse and/or sexual misconduct

- Operators should be properly policed for compliance with standards through onsight inspections

- Examine their facilities. Eliminate secluded areas. Establish standards for interior rooms

- Carefully screen employees

- Their problems can only be resolved (at least partly) by tort reform

- Rates will come down and availability will improve when experience improves and insurers' perceptions of day care providers as professional business people improves

- The cost of liability insurance merely reflects expected loss costs; anything that reduces loss costs will impact on premium

- Those eligible for experience rating may receive premium reductions through maintenance of loss control standards which result in fewer and less severe claims

- No, but Virginia could help by eliminating joint and several liability

**4. The day care industry in Virginia maintains that their history of claims does not justify the extent of the premium increases that they have seen over the past few years. We have given them loss ratio data from ISO indicating that while total claim amounts are small, the overall premium intake has been small too, thus resulting in high loss ratios. Do you have any claims information or position statement on the nature of your underwriting practices that would further clarify for the day care industry what is involved in determining premiums?**

COMMENTS:

- Aetna's Virginia experience is so small as not to be credible (less than $75,000 in premium for the past five years); countrywide, the company's 5-year loss ratio is 96%

- Our loss history in this class in Virginia is negligible. The setting of rates for a very long tail liability exposures is very intricate, and very difficult to substantiate to members of the public. Interest rates earned on loss reserves are a key factor, as was market segmentation of the insurance industry. Mostly surplus lines carriers wrote in this area; they were recently impaired financially through heavy losses from various classes of business

- We don't have any VA claims information to provide you since we don't have any policies with the Incidental Child Care endorsement. We determine the premium for this endorsement based on the amount of liability and medical payments coverage they carry. Currently this premium ranges from $25 -$32. Over the last few years we have not had a premium increase for this endorsement thus, we don't feel this is an excessive premium.

- Rates from including the attendees (staff) in the premium medical payments coverage have been ridiculously low in the past in comparison to student A & H coverage
- Historically we have not declined to write any risk falling within the confines of our charter. Stringent licensing requirements, including physical inspection of premises and checking of criminal records and highest professional standards throughout should help
- Claims data provided
- We utilize ISO premium and loss figures to determine our rates. Because our experience is somewhat better than ISO, we are deviating from ISO
- Defense expense is high potential and a lot of the problem
- Our rates are based on ISO data
- We rely on ISO data as our writings are not large enough to be statistically relied upon for actuarial purposes
- Traditionally the class produces a premium which is not commensurate with losses resulting from current court decisions which are more concerned with redistributing wealth than assessing damages
- We report data to, and rely upon, Insurance Services Office for filing of rates, premium basis, etc. ISO should be consulted concerning this item
- Our premium volume by itself is too small to justify premium revisions. Industry figures must be utilized. Any one claim can more than distort experience figures for many years
- We do not have enough data to support our own rates for day care centers. We use the ISO rates
- ISO's data is relatively meaningless; the bulk of this coverage has been written by a few specialty carriers who do not report to ISO

5. **Recent data indicated that 65% of child abuse allegations are falsely reported, would your company consider the possibility of insurance coverage for defense fees for allegations of sexual abuse on the condition that no judgement or settlement against the insured is actually made?**

Yes - 4 (11%)
No - 27 (71%)
N/A - 7 (18%)

COMMENTS:

- Defense costs are a major factor in developing premiums for day care coverage; providing defense cost coverage for situations not covered by the policy (such as sexual abuse) would be confusing.

- We would not think this is a plausible approach. Defense fees are currently a major portion of losses, they are not "capped" and must be monitored in predicting final loss levels. Settlements come last in the process and can't be precluded

- We will not cover defense fees as we are building an exclusion for this into all of our policies

- Already do provide defense fees for the insured from an allegation leveled against him until such time the insured is either relieved from or judgement declared

- The 35% of abuse cases which are substantial can result in large settlements

- We specifically exclude any child molestation claims from both a coverage, as well as a defense, standpoint. We feel it is against public policies to provide insurance monies as a defense for a criminal act that goes against public policy

- Defense within limits would be better

- Including defense fees in the coverage would further exacerbate the premium increase problem and possibly make the class even less attractive to insurers

- "The plaintiff has nothing to lose" attitude makes this impractical. The impact of defense costs adversely effects this class. Abuse claims, from whatever source or kind, should not be insurable. This type of activity (abuse) must be controlled by statutes, with appropriate criminal penalties. Abuse is an uninsurable risk. If mandated to be covered by insurance, we will be unable to participate in this market

- Coverage availability would probably increase if child abuse claims and their defense could be excluded from the policy

- We would not be willing to provide this coverage where the insured is the accused; falsely reported allegations of abuse can be eliminated in the commercial setting through proper supervision and "witness" procedures; an employee should never be alone with a child

- Our reduced limits for sexual abuse endorsement does provide for defense and moderate damage limits

- Expense is a substantial item, the emotional element makes these cases difficult to defend and there is the danger of a "bad faith" charge if the defense is not successful

- Only if Virginia law would be changed so that defense costs are assessed against the plaintiff in a case of false accusations

# APPENDIX C

## DAY CARE LIABILITY INSURANCE
## SURVEY OF OTHER STATES

States Responding (N = 41)

Alabama
Alaska
Arizona
California
Colorado
Connecticut
Delaware
District of Columbia
Florida
Georgia
Idaho
Illinois
Indiana
Iowa
Kansas
Kentucky
Maine
Maryland
Minnesota
Mississippi
Missouri
Montana
Nebraska
Nevada
New Jersey
New Mexico
New York
North Carolina
North Dakota
Ohio
Oklahoma
Oregon
Pennsylvania
Rhode Island
South Dakota
Tennessee
Texas
Utah
Washington
Wisconsin
Wyoming

## Summary of Results

A survey was mailed to all other state insurance commissioners to identify the extent of the liability insurance problem for day care facilities nationwide. Forty-one states responded.

Of those 41:

88% indicated day care operators had experienced cancellations and nonrenewals within the past year

86% indicated day care operators had experienced dramatic rate increases

73% indicated that some companies licensed in that state had stopped writing day care coverage all together

32% pointed to other factors occurring in their state indicating a liability insurance crisis

49% have adopted reforms in an attempt to cope with the problem

Responses to the survey of other states have been reported in the form of comments to specific questions.

1. **Have day care operators in your state experienced problems with cancellation or non-renewal of their liability insurance within the past year?**

No - 5
Yes - 36

COMMENTS:

- The cancellation and non-renewal problem does not appear as severe as 1985 partly due to the approval of sexual abuse exclusions (Alabama)
- Some companies left the state; others quit writing day care. In some cases, the company changed the underwriting criteria (Alaska)
- Many "standard" carriers cancelled or non-renewed when reinsurance for this market became difficult (Arizona)
- In summer of 1985, day care providers were facing mass mid-term cancellation problems (California)
- No, for family day care (covered by Homeowners Policy) but yes, for association accounts; primary consideration is cost, availability is not a problem (Connecticut)
- The problem was the most severe during the fall and winter 85/86. There are now programs available. Affordability for small centers is now an issue (Delaware)
- Not as much problem with cancellation as with non-renewal. The market has contracted; surplus lines taking up the slack. Some home day care operators (greater than 6 childen) are going bare (Florida)
- Some operators had experienced cancellation (perhaps 10%), most have been quoted considerably higher rates (Georgia)
- We have not received more than 5 - 10 calls. The media special surveys indicate a crisis (Idaho)
- Several non-renewals due to company withdrawal from market (Illinois)
- Companies have responded to the problem of sexual abuse, defense costs, and limited capacity by non-renewing (Indiana)
- Especially when covered by Homeowners endorsements (Kansas)
- During the last half of 1985 carriers non-renewed day care centers; however, we now have a company who will write coverage (Kentucky)
- Widespread for both homes and larger operations (Maine)
- Extensive (Maryland)

- One carrier insured almost all day care facilities in the state. When that carrier stopped writing, the facilities were left without insurance (Minnesota)
- Those operating outside the confines of a church have difficulty in securing a policy (Mississippi)
- Some carriers have dropped out; day care is placed through surplus lines coverage (Montana)
- Mostly non-renewals or renewals with restrictions (Nebraska)
- Unavailability and unaffordability of insurance (New Mexico)
- There are many carriers who have decided not to renew the entire class of business or whose reinsurers have withdrawn from the market therefore limiting the primary insurer's policy limits and their ability to write new business. (New York)
- Small day care operators that have less than 5 children and are not licensed (North Carolina)
- According to surveys conducted by child care centers in late 1985, 34 (31%) of the 111 agencies reporting had been cancelled or non-renewed (Pennsylvania)
- Mild, issue of affordability not availability (Rhode Island)
- From complaints and inquiries we have received, we believe many day care centers were forced to go without insurance or be placed with a surplus lines carrier. (Texas)
- Mainly the standard carriers have been cancelling this line of business; high risk companies have for the most part kept this business but have raised the premiums (Utah)
- Both family day care (up to twelve) and larger centers have experienced both larger rate increases and cancellations (Washington State)
- Non-renewals; surplus line insurers are writing most day care risks (Wyoming)

2. **Have day care operators in your state experienced dramatic rate increases for their insurance coverage?**

No - 6
Yes - 35

COMMENTS:

- CIGNA asked for 10%, Western World took 30%; Operators not applying through our MAP experience rate increases because they went to surplus lines companies (Alaska)

- Increases of 200% to 400% were common due to the day care operators having to go to specialty carriers (Arizona)

- The increase ranges from 400% to 900% over last year (California)

- Premiums have doubled and tripled (Colorado)

- Currently, H.O. extension provides 100/300, 1000 medical payment for $125.00 per year for up to 6 children (Connecticut)

- Rates have increased but not dramatically compared to other lines. The biggest problem in this area occurs when homeowners endorsements are non-renewed for in-home care centers and commercial policies must be bought to replace them (Delaware)

- Some have experienced double and triple the rates of 1983 (Florida)

- Not much different than other commercial lines; rate discounts in 1980-83 not now being given; increases of 200% to 300% to bring rates back to filed level (Georgia)

- We have been advised of doubling and tripling the original premium (from 1984 - to 1985 - to 1986) (Idaho)

- 2 times to 4 times as an average (Illinois)

- Coverages have been limited and overall increases have been large. However, the increases have not been disproportionate compared to other liability lines with similar exposure (Indiana)

- Some Kansas day care centers have experienced premium changes that exceed 500%, others have experienced premium changes from less than $100 to a renewal premium of $250 (Kansas)

- Rates have doubled and tripled (Kentucky)

- Many 300% or more - although many were written on a homeowners policy as incidental business (Maine)

- Extensive (Maryland)

- Day care centers have experienced dramatic increases according to phone calls we have received from providers (Minnesota)

- The base rate change is not dramatic but schedule rating and consent to rate increases are present (Mississippi)

- The small operators that care for only a few children in their homes cannot afford the present high premiums (Missouri)

- 200 - 400%, minimum premium for new operators, $350/year to $700/year (Montana)

- There may be some exceptions but most were not "dramatic" (Nebraska)

- Some of the large centers more than tripled (Nevada)

- Two or three times of previous annual premiums even though no losses were reported (New Mexico)

- One insured's premiums went from $87 in 1984 to over $1400 in 1985 to over $3000 in 1986; increases of 50% to 100% are not unusual (New York)

- The exception would be the Continental Insurance Company has a new program for the large day care centers which is very competitive (North Carolina)

- From an average of $80.00/yr. premium to an average of $350.00/yr. (in-home care) (North Dakota)

- According to surveys conducted by child care centers in 1985, 63 (56%) able to obtain renewal coverage had experienced increases as great as 500% (Pennsylvania)

- Varies - those who had business operations in their home faced real problems when forced to purchase business coverage (Rhode Island)

- Those who had been paying $100 - $200 with standard carriers and then have had to go to sub-standard carriers have seen a substantial increase. Now they are paying around $50 for each child they are licensed to care for with a MP of $1,000 to $2,500 (Utah)

- A random survey found an average increase of 104% in premium over the past two years (Wisconsin)

- Some increases have been so extreme that the insured questions if they should stay in business (Wyoming)

3. **Have any insurance companies licensed in your state stopped writing day care coverage all together?**

No - 11
Yes - 30

COMMENTS:

- State Farm is just renewing its existing Commercial Day Care Program (Alaska)

- Approximately 10 (Arizona)

- Coverage is readily available, no significant market reduction (Connecticut)

- Approximately 15 (Colorado)

- Probably between 5 - 10 (Delaware)

- All companies have refused to endorse a "business pursuit" on H.O. policies (Idaho)

- Approximately 5 companies with others limiting their writings and imposing strict underwriting guidelines (Illinois)

- Approximately 8 (Kentucky)

- We have not maintained a list; most of the companies that stopped were were those in connection with homeowners (Kansas)

- They claim that nationwide statistics indicated adversity of the coverage due to child abuse, neglect, etc.

- Unknown number on capacity basis plus Mission (Maryland)

- Approximately 10 - 15 (North Carolina)

- In home care (only 2 surplus lines carriers left) (North Dakota)

- Three (based on telephone survey) (Wisconsin)

**4. Are there other factors occurring in your state that point to a liability insurance crisis for day care?**

No - 28
Yes - 13

COMMENTS:

- Legal climate before tort reforms (Alaska)

- Adverse publicity in the child abuse litigation; adverse loss experience incurred for those who wrote the business (California)

- Insurers do not know how to underwrite day care centers and homes. Day care centers have filed a class action suit which affects availability of insurance (Colorado)

- Beginning 7-1-85 day care providers with more than 5 children are required to obtain $100,000 or more of liability insurance; many complaints on availability, affordability and severe underwriting restrictions; effective 7-3-86 this requirement for insurance was repealed (Florida)

- The state legislature has failed to address state licensing of day care centers for two sessions; day care licensing and inspection is a local option, and in some cases, there is no compliance. (Idaho)

- Companies have made numerous policy filings: i.e., a claims-made with defense costs included and several child/sex abuse exclusions of various types (Illinois)

- Our primary market gap is 4, 5, and 6 children in a private home, and with the homeowners carrier refusing coverage (Nevada)

- By reducing the terms of coverage, there has been a defacto increase in rates; for example eliminating the coverage for child abuse destroys the whole purpose of the coverage and, thus, centers are paying more for less coverage (New Jersey)

- For a time early in 1986 it appeared that coverage was difficult to get; now premiums are still high but we have a few companies to which people can apply (Texas)

- Coverages are more limited; exclusions have been added (Utah)

5. **Has your state adopted any reforms in an attempt to cope with the problem of day care insurance availability/affordability?**

No - 21
Yes - 20

COMMENTS:

- Tort reforms proposed in 1985 failed (Alabama)

- MAP: CADIS (Coordination of Alaska Day Care Insurance Search) (Alaska)

- We have amended the insurance requirement to lower the limits from $300,000 to $100,000 per occurrence and $300,000 aggregate and clarified the language to that extent. (California)

- Developed MAP plan; passed insurance legislation providing a 90 day advance notice in case of cancellation, nonrenewal, unilateral increase in premium and reduction in coverage on renewal (Colorado)

- MAP available; toll free hot line established (Connecticut)

- Recent establishment of JUAs may affect day care providers (Florida)

- A legislative package including tort reform has passed both houses (Illinois)

- Market Assistance Plan implemented for all commercial lines (Kansas)

- New law adding mandatory endorsement of Homeowner's insurance for small day care providers (Maryland)

- We have a Minnesota Joint Underwriting Association which has the authority to issue insurance for day care facilities and other businesses (Minnesota)

- Missouri Market Assistance Program (Missouri)

- MAP has been instituted (Montana)

- A MAP program; legislation also proposed to license all employees of child day care centers (New Jersey)

- Some bills were introduced in the 1985 General Assembly to tighten restrictions on child care providers (North Carolina)

- We have a list of companies writing day care; with our consumer hot line program, they can get this information (North Dakota)

- Texas Commercial Liability Market Assistance Program (Texas)

- We are now in the process of organizing a hot-line within the department (Utah)

- The legislature enacted a JUA for day care and a MAP; in addition, the day care association has authority to self-fund (Washington State)